FOR ARGUMENT

Supreme Court, U.S.
FILED
MAR 13 1978
MICHAEL RODAK, JR., CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-454

MOORMAN MANUFACTURING COMPANY,
Appellant,

vs.

G. D. BAIR, DIRECTOR OF REVENUE,
STATE OF IOWA,
Appellee.

ON APPEAL FROM THE SUPREME COURT
OF THE STATE OF IOWA

REPLY BRIEF FOR THE APPELLANT

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INDEX

I. Brief of Appellee G. D. Bair 2

II. Brief Amici Curiae of Iowa Manufacturers Association et al. 8

III. Brief Amici Curiae of Multistate Tax Commission et al. 10

Conclusion 11

Citations

CASES

Austin v. *New Hampshire*, 420 U.S. 656 (1975) 7, 8

Bass, Ratcliff & Gretton, Ltd. v. *State Tax Commission*, 266 U.S. 271 (1924) 5, 9

Bibb v. *Navajo Freight Lines, Inc.*, 359 U.S. 520 (1959) 7

Butler Bros. v. *McColgan*, 315 U.S. 501 (1942) 4, 9

Evco v. *Jones*, 409 U.S. 91 (1972) 9

Freeman v. *Hewit*, 329 U.S. 249 (1946) 6, 9

General Motors Corporation v. *District of Columbia*, 380 U.S. 553 (1965), *rev'g* 336 F.2d 885 (D.C. Cir. 1964) 2,4, 5, 7

General Motors Corporation v. *Washington*, 377 U.S. 436 (1964) 6

Gwin, White & Prince v. *Henneford*, 305 U.S. 434 (1939) 6

Hans Rees' Sons, Inc. v. *North Carolina*, 283 U.S. 123 (1931) 4

J. D. Adams Mfg. Co. v. *Storen*, 304 U.S. 307 (1938) 9

Kent-Coffey Mfg. Co. v. *Maxwell*, 291 U.S. 642 (1934), *aff'g per curiam* 204 N.C. 365, 168 S.E. 397 (1933) 5, 9

Norfolk & Western Railway Co. v. *Missouri State Tax Commission*, 390 U.S. 317 (1968) 8, 9
Northwestern States Portland Cement Co. v. *Minnesota*, 358 U.S. 450 (1959) 5, 8, 9
Raymond Motor Transportation, Inc. v. *Rice, Secretary, Wisconsin Department of Transportation*, 46 U.S.L. Week 4109 (U.S. Feb. 21, 1978) 7
Standard Pressed Steel Co. v. *Washington*, 419 U.S. 560 (1975) 6
Underwood Typewriter Company v. *Chamberlain*, 254 U.S. 113 (1920) 5
U. S. Steel Corporation v. *Multistate Tax Commission*, 46 U.S.L. Week 4115 (U.S. Feb. 21, 1978) 10

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The three briefs in opposition among them contain some rewording of old arguments that could be misleading, and even some matters completely irrelevant to the case. We want to ensure that the Court will not be distracted from the sole issue in the case: the unconstitutionality, under the Commerce, Due Process and Equal Protection clauses and a basic principle of federalism, of the Iowa single-sales-factor formula for attributing to Iowa the entire income derived by Moorman Manufacturing Company from manufacturing in Illinois products which it sells to customers located in Iowa. We will try to clarify.

I. BRIEF OF APPELLEE G. D. BAIR

Appellee's brief rests upon repetition of four themes: (1) Iowa didn't tax 100% of the relevant income; (2) taxpayers have such a heavy burden of proof as to preclude review of any formula; (3) "rough approximation" in apportioning income is sufficient; (4) hypotheticals don't prove anything. We can agree with three (3) and four (4) as abstract propositions, but they avail appellee nothing here; while two (2) exaggerates and one (1) is wrong.

(1) Appellee repeats so often the claim that the assessments don't attempt to tax 100% of Moorman's net income derived from goods sold to Iowa customers as to suggest he is merely trying to convince himself of what he knows is not so. The point is not debatable, notwithstanding that the Supreme Court of Iowa stumbled over it when presented, not by the appellee, but by an *amicus*. It is very simple: the statute defines net income, which prescribes the same tax base for all taxpayers, local and foreign. Then the statute attributes to Iowa the amount of that income measured by a fraction, the numerator of which is gross receipts from customers in Iowa and the denominator gross receipts from all customers. The mere statement of the statute itself is sufficient, without more, to establish unequivocally that the assessments aim at 100% of the relevant income. The mathematical proof thereof is shown by Moorman's actual figures in Appendix E to our brief and illustrated by a simplified hypothetical at pp. 27-28 of our brief.

In *General Motors Corporation* v. *District of Columbia*, 380 U.S. 553 (1965), this Court fully recognized that a single-sales-factor formula necessarily taxes 100% of the income from the pertinent segment of the business (at 559):

> "The use of an apportionment formula based wholly on the sales factor, in the context of general use of the three-factor approach, will ordinarily result in multiple taxation of corporate net income; for the States in which the property and payroll of the corporation are located will allocate to themselves 67% of the corporation's income, whereas the jurisdictions in which sales are made will allocate 100% of the income to themselves."

The argument (borrowed by the Iowa court) that less than 100% of Moorman's apportionable income was attributed to Iowa ignores the Iowa statutory definition of "net income" and attempts to expand that definition as to Moorman from the amount agreed upon. That effort did not extend to other taxpayers, but to Moorman alone—which does not commend itself as equal protection.

(2) The trial court's findings of fact thoroughly dispose of the burden of proof argument. We begin, as we must, with the underlying assumption that sales to Iowa customers were equally profitable with all other sales—the *statute* makes the assumption, not we, and we do not attack it, as appellee does in complaining that we have not shown by separate accounting that the assumption is valid.

All division of income formulae necessarily rest upon assumptions. As appellee says, a taxpayer has a tough time upsetting those assumptions. The situation here is that we accept the aforesaid assumption upon which the Iowa statute is necessarily based, and our opponents are challenging us—not to overcome, but to prove—the assumption inherent in their statutory formula. We don't have to prove its validity—if the assumption is invalid the statute is invalid. In attacking it, they assert its in-

validity (as to which, of course, they would have the burden of proof). Theirs is the most self-defeating argument imaginable: the Iowa formula doesn't measure income attributable to Iowa and therefore is valid to attribute income to Iowa.

Repudiating its own assumption, Iowa's brief insistently demands separate accounting, such as was used in *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123 (1931) (which was not a unitary business). *Butler Bros.* v. *McColgan*, 315 U.S. 501 (1942) establishes that separate accounting is impermissible for a unitary business such as Moorman. Separate accounting *apportions* nothing; rather it specifically assigns situs to each of *numerous* items of income and expense. Only a *single* item is subject to apportionment, and in the case of the Iowa statute that item is "net income" as defined by the statute.

(3) To be valid, an apportionment formula must reach "a rough, practical approximation of the distribution of either a corporation's sources of income or the social costs which it generates." *General Motors Corporation* v. *District of Columbia, supra.* The Iowa formula fails to make such a rough approximation because it does not take cognizance of the locus of either manufacturing labor or capital. This fatal flaw is not present in either a single property formula or a three factor formula, which this Court has approved.

(4) Hypotheticals are not offered to prove anything. The claim (p. 18) that our statement (that the sales factor merely identifies income and does not apportion it) "is a mere economic theory" is wrong on two counts: in the field of taxation constitutional principles embody economic realities; and we didn't merely state it—we demonstrated it mathematically, in a simplified hypothetical in

the text (pp. 27-28) and with Moorman's actual figures in the Stipulation, on pages 12 and 13 of our opening brief, and in Appendix E to our opening brief. Furthermore, this Court has recognized the fact: "the geographic distribution of a corporation's sales is, by itself, of dubious significance in indicating the locus of either" sources of income or social costs. *General Motors Corporation* v. *District of Columbia, supra.*

* * *

The appellee's brief picks up some of the irrelevancies of the brief filed by the Multistate Tax Commission, notably the absence of consideration of Moorman's subsidiaries, none of which, incidentally, had any activities or customers in Iowa. Moorman's apportionable income, the apportionment factors, and the tax rates are all agreed upon, the sole question being whether the sales factor may be employed alone to the complete disregard of all other considerations.

On p. 17 of his brief, appellee asserts that some of the apportionment formulae approved by this Court attributed to the taxing state more income than Iowa's formula would have attributed, followed by the *non sequitur* that therefore the Iowa formula is valid. The assertion is correct when the taxpayer's factory was in the state—*Underwood Typewriter Company* v. *Chamberlain*, 254 U.S. 113 (1920), *Kent-Coffey Mfg. Co.* v. *Maxwell*, 291 U.S. 642 (1934)—while the opposite is true if the local activity was selling—*Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U.S. 271 (1924), *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450 (1959), *Butler Bros., supra.* Equally irrelevant is the fact that each of these formulae would have attributed less income to Iowa in the facts of this case than would Iowa's.

Relying on *General Motors Corporation* v. *Washington*, 377 U.S. 436 (1964), and *Standard Pressed Steel Co.* v. *Washington*, 419 U.S. 560 (1975), appellee asked at p. 30: "If Iowa . . . could have levied an unapportioned gross income tax upon Moorman . . . why cannot Iowa levy its tax upon a lesser apportioned net amount?" *General Motors Corporation* v. *Washington, supra* and *Standard Pressed Steel Co.* v. *Department of Revenue, supra*, involved gross receipts taxes which, in their nature and incidence, are indistinguishable except semantically from sales and use taxes, generally payable to the state of the user and to no other state. *Gwin, White & Prince* v. *Henneford*, 305 U.S. 434 (1939); *Freeman* v. *Hewit*, 329 U.S. 249 (1946). Presumably, no other state could properly tax Standard Pressed Steel's receipts from Washington customers. Illinois does tax (quite properly) income from goods sold to Iowa customers. Multiple taxation is avoided in the gross receipts tax cases, not by apportionment, but by allowing a single state to impose the entire tax. Since several states are reasonably entitled to tax parts of the net income of a multistate business, apportionment is necessary. Appellee seemingly agrees that apportionment is required in this case, but Iowa presents a formula which does not apportion but seizes the entire relevant income.

Disparities in the amounts of tax induced by varying tax schemes are irrelevant to the validity of any scheme, but since appellee raises the point, we note that had Iowa employed the Washington scheme its tax would have been less than 65% in 1972 and no more than 86% in any year of that demanded by Iowa.

Obviously erroneous is the statement on p. 18 of appellee's brief: ". . . The Iowa sales formula apportions net income to Iowa on the basis of an interstate corporation's business transacted in the Iowa market place—an obvious

income producing activity". Moorman's business in Iowa is transacted at its warehouses and through its salesmen. The fact is that the Iowa formula has no relation to any of the "business transacted" nor to any of the "activity" at all but is governed solely by the location of customers, which clearly is not an income producing factor.

The repeated (e.g., pp. 19, 32-33) argument that Iowa is free to go its own way regardless of what other states do is without merit. That would lead to a conclusion that each state may use a different theory, each selecting the one that gives it the greatest tax yield—with the poor taxpayer subjected to multiple burdens notwithstanding the Constitutional intent to prevent such a result. The clearest statement is in *Bibb* v. *Navajo Freight Lines, Inc.*, 359 U.S. 520 (1959),[1] which, while noting that state safety regulations are almost never disturbed, struck down Illinois' rule requiring curved truck fender flaps, perfectly valid by itself, solely because of its incompatability with the rules of other states requiring straight flaps. *General Motors Corporation* v. *District of Columbia, supra*, makes the same point in a tax matter. Hence the principle: if many states do it one way, and one state does it another way with resulting unreasonable burdens on interstate commerce, the one state's rule is unconstitutional—unless the one state's way is demonstrably superior, which it was not in *Bibb*, and assuredly was not in *General Motors Corporation* and is not here.

Appellee's reliance on the quotation (to the effect that validity of one state's tax does not depend upon another state's), out of context, from *Austin* v. *New Hampshire*, 420 U.S. 656 (1975), is misplaced. In that case this Court held that New Hampshire's income tax was

1. Reaffirmed this term in *Raymond Motor Transportation, Inc.* v. *Rice, Secretary, Wisconsin Department of Transportation*, 46 U.S.L. Week 4109 (U.S. Feb. 21, 1978).

violative of the privilege and immunities guaranty because it applied to nonresidents but not to residents, and that it was not saved by the fact that another state (Maine) might avoid the effect through adjustment of its own income tax.

II. BRIEF AMICI CURIAE OF IOWA MANUFACTURERS ASSOCIATION ET AL.

The principal argument seems to be that this Court either cannot or should not decide this case. The Association's support for that position rests on inverted thinking. The Association quotes from Justice Frankfurter's dissent in *Northwestern States, supra,* without noting that he would not have allowed the states to tax in the absence of Congressional authorization: "the solution to these problems ought not to rest on the self-serving determination of the States of what they are entitled to out of the Nation's resources". 358 U.S. at 477.

The brief starts with a misleading version of the Question Presented, p. 3, in that it assumes a tax cannot be invalid unless it produces a "grossly distorted result", and then implies, contrary to fact, that there is no evidence of such a result in this case. Tax transgression of constitutional bounds can occur in other ways than producing grossly distorted results, although that is a convenient test for the inapplicability to particular facts of a normally valid formula. *Norfolk & Western Railway Co.* v. *Missouri State Tax Commission,* 390 U.S. 317 (1968). In *Austin* v. *New Hampshire, supra,* the tax was invalid although there was, as to the taxpayer, *no* result, distorted or otherwise.

Several of appellee's arguments are repeated: rough approximation; statutory assumption; separate accounting; and gross receipts taxes. We will not repeat the rebuttal.

In presenting the surprising argument that interstate commerce is not involved, the Association quarrels not only with us but with the State since the "apportionment" part of the statute applies *only* to interstate commerce. Most[2] of Moorman's *sales* were from Iowa warehouses, but all its *business* was in interstate commerce. This is a net income tax, not a sales, use or gross receipts tax.

The Association's Summary Argument displays lack of understanding. Holding the Iowa formula invalid would not "overrule" a single prior decision of this Court, and is, in fact, strongly supported by many, from *Underwood* through *Bass, Ratcliff & Gretton, Norfolk & Western, Northwestern States, Kent-Coffey* and *Butler Bros.,* all *supra.*

The claim that the Court is being asked to legislate a formula is not entirely false since the brief of the Multistate Tax Commission urges just that. But neither *party* has advanced such a request and Appellant has been at pains to point out that there is no issue before this Court other than the single, simple question of the constitutionality of the assessments based on the single-sales-factor formula.

We think it is well established that *risk* of multiple taxation of the same income is constitutionally infirm, *J. D. Adams Mfg. Co.* v. *Storen,* 304 U.S. 307 (1938), *Freeman* v. *Hewit, supra, Gwin, White & Prince, supra, Evco* v. *Jones,* 409 U.S. 91 (1972), but also the argument on that point, pp. 35-36, carefully ignores the fact that not only risk, but *actual* double taxation, has been established in this case. Appellee agrees with us that risk alone is sufficient (p. 27 of his brief).

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2. But not all, as they say. Some shipments were from the factory direct to customers (A. 3; our brief p. 4 fn. 2).

At page 39 of its brief, the Association extends its argument about equal protection in a discussion of relative degrees of "scrutiny" which seems to us to offer no help. The fact is that an out-of-state manufacturer selling into Iowa is disadvantaged as compared to an in-state manufacturer selling either in or out of the state. Our brief pp. 32-35.

III. BRIEF AMICI CURIAE OF MULTISTATE TAX COMMISSION ET AL.

Counsel for the Multistate Tax Commission face a difficult dilemma. They would like this Court to endorse their three-factor formula, but they do not want to offend Iowa (as a potential candidate for their Compact) by supporting Moorman's claim for relief. The result is a mixture of inconsistent ideas, some of which could divert attention from the only issue in this case.

The argument tumbles over its internal conflicts: the Iowa formula reasonably apportions net income, but the Iowa formula unconstitutionally discriminates against interstate commerce; although the statute is unconstitutional Moorman is not entitled to relief because Iowa might have used a different tax base. The only part of that argument that makes any sense is that there is an unconstitutional discrimination against interstate commerce.

On page 5 an attempt is made to import one of the issues in *U. S. Steel Corporation* v. *Multistate Tax Commission*, 46 U.S.L. Week 4115 (U.S. Feb. 21, 1978): the extent, if any, to which a taxpayer's liability may be enlarged by attributing to it income which is not its own. There is no excuse for an outsider to attempt to drag that unrelated question into a case in which it does not exist.

The Commission's request that this Court legislate the three-factor formula is completely inappropriate, being unnecessary (and undesirable) for disposition of the case and contrary to the case-by-case adjudication which this Court follows. (It is also surprising in view of the Commission's determined opposition to any such action by Congress.)

The footnote on p. 6 tries once more to confuse base with apportionment. No matter how narrow the definition of base, it must still be "fairly apportioned". The definition applies to all taxpayers alike. So restricted a base as is suggested would have its effect on rate, but not on apportionment.

CONCLUSION

A very simplified summary of appellant's position is:

(1) The Iowa single-sales-factor of attribution does not "apportion" income but merely identifies the total income from the relevant segment of the business, and then attributes 100% of it to Iowa. Its recognized purpose and effect is to subsidize exports and impose a tariff on imports.

(2) Since income "is the product of capital or labor or both combined" Moorman's income from manufacturing goods in Illinois and selling them to Iowa customers cannot be attributed solely to the loci of customers but must be attributed to the activities (including the sales activities in Iowa) which produce the income and incur the social costs.

(3) The sales factor, alone or in conjunction with valid factors, cannot be justified on any economic or fiscal (and hence constitutional) grounds for apportionment of net income; but it may be tolerated as a one-third part of a three-factor formula universally applied.

(4) Since Illinois has properly taxed a substantial portion of the relevant income, Iowa's reaching for 100% thereof causes double taxation in violation of the commerce clause.

(5) Since much of the earning of the relevant income took place in Illinois, Iowa's attempt to tax all of it is reaching outside its jurisdiction in violation of the due process clause, and, more importantly, of the fundamental principle of federalism that a state may not project itself beyond its geographical boundaries.

(6) For reasons earlier stated, the Iowa formula likewise transgresses the equal protection clause.

(7) As discussed in the *amicus* brief of the economists in support of the Jurisdictional Statement, the economic and fiscal consequences of allowing the Iowa decision to stand would be substantially and extensively damaging.

(8) This Court should declare the Iowa single-sales-factor formula constitutionally impermissible. It need do no more to settle this controversy, the parties having agreed upon the consequence of such a holding.

Respectfully submitted,

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